

Arizona Department of Insurance

2006 Market Monitoring

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Private Passenger Automobile Insurance

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I. Rate System:

Arizona's "open competition" law, applicable to Private Passenger Automobile ("PPA") insurance, prohibits insurers from charging excessive, inadequate or unfairly discriminatory rates or rates that will have the effect of destroying competition or establishing a monopoly. By statute, a rate is not excessive if "a reasonable degree of price competition" ("RDPC") exists at the consumer level. The law presumes a competitive market exists unless the Director, after a public hearing, determines that a RDPC does not exist in the market.

II. Market Monitoring Methodology:

The Department relies upon annual statements filed with the Department, insurers' responses to an annual Department survey, current trade press articles, and A.M. Best data to monitor the market.

The purpose of market monitoring is twofold: to assist the Director in determining whether competition exists; and, to assist consumers with their questions and concerns about the availability of insurance.

III. Annual Statement Data:

The 2005 annual statements for all PPA segments evidence that:

- In 2005, insurers' direct written premiums increased 4.63% over 2004 and their direct incurred loss ratio increased by 1.35%.
- Twenty-two insurers wrote at least 1% of the market.
- There are 289 insurers that reported PPA liability data in 2005, but of these only 141 are actively seeking new business.
- The Top 25 PPA insurers wrote 75.23% of the market.

Historical Experience (All Insurers' Arizona State Page, Lines 19.1, 19.2 and 21.1, Annual Statement Data, Year Ending December 31)

| | 1 | 2 | 3 |
|------|-----------------|------------------------------------|-----------------|
| CY | Written Premium | Earned Premium | Paid Losses |
| 2005 | \$3,401,141,117 | \$3,354,828,610 | \$1,905,471,309 |
| 2004 | \$3,250,611,018 | \$3,213,689,222 | \$1,810,348,909 |
| 2003 | \$3,093,753,000 | \$3,027,544,000 | \$1,739,860,000 |
| 2002 | \$2,817,024,000 | \$2,747,956,000 | \$1,796,898,000 |
| | 4 | 5 | |
| CY | Incurred Losses | Incurred Loss Ratio (Col 4/ Col 2) | |
| 2005 | \$1,968,557,592 | 58.68% | |
| 2004 | \$1,842,275,163 | 57.33% | |
| 2003 | \$1,793,086,000 | 59.23% | |
| 2002 | \$1,876,998,000 | 68.31% | |

IV. Survey Responses:

In 2006, 179 insurers responded to the Department's PPA survey. These insurers had a 2005 market share of 99.37%. Overall, their response regarding current PPA market conditions was favorable and positive.

- **The majority of surveyed insurers said that:**
 - Competition is intense in the PPA market;
 - Price is important;
 - Coverage availability is not a problem;
 - Current pricing levels are just about right; and
 - Reinsurance is not problematic for only 31.86% of the market and is becoming less readily available.
- **The majority of the surveyed insurers said that their particular company:**
 - Considers the PPA line to be very important to their presence and success in Arizona;
 - Is competing in the market with some intensity;
 - Has had neither historical underwriting profitability nor unprofitability in PPA in Arizona;
 - Will maintain their current underwriting and risk-eligibility approach at least through year-end 2006;
 - Is actively seeking new business;
 - Has not materially increased its declinations in 2006 as compared to 2005;
 - Considers Arizona's "open competition" rate law to be highly or very effective; and
 - Considers PPA to be a major line nationally.

V. Major PPA Market Trends:

Trend # 1. Although the PPA market continues to be concentrated in the Top 25 insurers, their market share decreased slightly in 2005. The Top 25 market share decreased to 75.23%, a decline of 1.58% since 2004. While the top two market leaders, State Farm Mutual Automobile IC and Farmer's IC, continue to maintain their respective market positions, their market shares have steadily decreased since 2001. American Family Mutual IC, in third market position, has decreased its market share after three years of increases. The top five insurers' 2005 market share and rank follow:

| Rank | Company | 2005 Market Share |
|------|---------------------------|-------------------|
| 1. | State Farm Mutual Auto IC | 13.79% |
| 2. | Farmers IC Of AZ | 9.87% |
| 3. | American Family Mutual IC | 7.78% |
| 4. | Allstate P&C IC | 4.57% |
| 5. | Allstate IC | 4.48% |
| | Total: | 40.49% |

Trend # 2. Market concentration is not discouraging insurers from entering the Arizona market. Thirty-three of the 179 insurers responding to the survey have been writing in Arizona less than three years. Of 289 insurers reporting liability data on their annual statements in Arizona, there are 148 latent insurers that could reenter the market.

Trend # 3. The majority of the market is actively seeking new business. In 2006, 87.40% of the market responded that it was highly or intensely seeking new business.

Trend # 4. Competition continues to be intense. The majority of the market (94.56%) responded in 2006 that market competition is high. The market share of non-standard insurers has decreased, reflecting the movement of business to standard or preferred insurers. Applications to the Arizona Assigned Risk Plan, the involuntary market, have continued to decrease.

Trend # 5. Groups play an important role. All Top 25 insurers are members of thirteen groups. Seven of the groups lost market share and six gained, resulting in an overall net gain of .72% for the thirteen groups.

Trend # 6. Total written premiums for Arizona's insurers is trending upward but at a slower pace. In 2005, Arizona's Direct Written Premium ("DWP") increased 4.63% compared to a 5.07% increase in 2004. A softening market (insurer rate changes during 2005 resulted in a weighted average total rate change of -0.9%) is slowing the DWP growth rate although Arizona's higher DWP may be a reflection of its population growth.

Trend # 7. The average policy premium increased. In 2005, both DWP and policy counts increased and the average policy premium increased to \$1,216 from \$1,193 in 2004. In addition, the average premium per

vehicle increased to \$916 from \$911 in 2004. Although the price per vehicle increased in 2005, the increase is 0.6% less than the previous year's price increase.

Trend # 8. Insurers report historical unprofitability for the PPA line. In 2006, 17.42%, a significant increase (compared to 4.69% in 2005), of the market does not view PPA as profitable. For insurers surveyed, the 2005 incurred loss ratio increased to 59.30% (up from 57.26% in 2004) and the combined ratio was 97.57% (up from 94.00% in 2004).

Trend # 9. The market has softened; however, pricing and underwriting considerations will continue. Insurers are taking a more conservative underwriting stance as 2.22% (compared to .65% in 2005) of the market will take a more conservative underwriting stance by year-end 2006. Competition and rising interest rates both have an effect on insurers and the approach they take to increase their market share while remaining profitable.

VI. Conclusions:

The Arizona PPA market remains healthy, competitive and continues to grow. The PPA industry, overall, is profitable and insurers view the Arizona market favorably and attractive for new insurers.

Competition among the Top 25 and insurer groups is intense. Lower rate increases, rate decreases and price competitiveness among insurers for increased market share benefits consumers. The market appears willing to insure higher rated risks and fewer drivers are seeking coverage under the Assigned Risk Plan.